

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 00-0189
ADJUSTED GROSS INCOME TAX
For the 1996, 1997, and 1998 Tax Years**

NOTICE: Under 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Applicability of the Adjusted Gross Income Tax to That Portion of Lease Payments Designated as Property Tax.

Authority: IC 6-3-1-3.5(b); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax. Ct. 1996); 45 IAC 3.1-1-8(3)(b).

Taxpayer protests the decision to include that portion of lease payments – specifically designated as property tax payments – within the taxpayer's income subject to the state's adjusted gross income tax. Taxpayer maintains that the property tax payments should not be included as part of its gross receipts, that the taxpayer was acting merely as a fiduciary in collecting the property tax, and that the property tax receipts should not be added back as a modification to Indiana adjusted gross income.

II. Denial of Tax Refund for Calendar Year Ending June 30, 1995.

Authority: IC 6-8.1-5-2; 45 IAC 3.1-1-94.

Taxpayer argues that it is entitled to a tax refund for the financial year ending June 30, 1995. Because it is being assessed additional tax for the previous two years, taxpayer believes that it should not have been denied the tax refund for the tax year ending June 30, 1995.

III. Abatement of the 10-percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that the Department should exercise its discretionary authority to abate the 10-percent negligence penalty for all years included within the audit period. Taxpayer asserts that it acted in good faith and used reasonable care in filing its state income tax returns.

STATEMENT OF FACTS

Taxpayer is incorporated in and maintains its headquarters in California. Taxpayer leases and sells various computers, software, computer related equipment, and other items of personal property to customers located throughout the United States. Taxpayer leases equipment to customers located in Indiana and derives Indiana source income from that equipment. Taxpayer retains ownership of the equipment it leases. Taxpayer's leases are non-cancelable "net" leases for terms ranging from two to five years. The leases contain provisions which require the lessee (customer) to maintain and service the equipment, insure the equipment, and to pay all taxes on the equipment.

DISCUSSION

I. Applicability of the Adjusted Gross Income Tax to That Portion of Lease Payments Designated as Property Tax.

Taxpayer is of the opinion that it should not be subject to Indiana adjusted gross income on that portion of lease payments which are designated as property tax. Taxpayer is the owner of the leased property and is responsible for the property tax on the leased equipment. Taxpayer maintains that it is simply conducting a "pass-through" transaction whereby it collects property taxes on behalf of the lessees and remits the property taxes to the proper taxing jurisdiction. Taxpayer's standard lease contract includes a provision stating that, "All fees, assessments and taxes . . . which may now or hereafter become due or are imposed upon the ownership, sale, possession and /or use of the Property are to be paid by Lessee. While Lessee will be responsible for payment of all personal property taxes, [taxpayer] will file all personal property tax returns."

Taxpayer maintains that its typical lease arrangement is one in which the lessee is billed either quarterly or monthly. However, the lessee is billed once each year for the amount of property tax attributable to the equipment held by the lessee. According to the taxpayer, this arrangement provides evidence that the property tax is severable from the lease payments, and that the receipt of the property tax is not a taxable receipt of lease payments.

IC 6-3-1-3.5(b) provides the starting point for determining taxpayer's taxable income stating that the term "adjusted gross income" shall mean, "In the case of corporations the same as 'taxable income' (as defined in Section 63 of the Internal Revenue Code" The Department's Administrative Rules restates the basic principle at 45 IAC 3.1-1-8 stating that "'Adjusted Gross Income' with respect to corporate taxpayers is 'taxable income' as defined in Internal Revenue Code – section 63)" In Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax. Ct. 1996), the court held that the code provision was "plain and unambiguous." Id. at 1213. "Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 63, not as reported by the taxpayer." Id.

In calculating the taxpayer's adjusted gross income, Indiana begins with the federal definition as found in I.R.C. § 63. Having defined the Indiana taxpayer's federal adjusted gross income, the regulations provide for certain adjustments one of which is relevant here. 45 IAC 3.1-1-8(3)(b) provides for the add back of "[p]roperty taxes levied by a political subdivision of any state" The effect of the regulation is to subject property taxes, even if otherwise not subject to the federal adjusted gross income tax, to the state's adjusted gross income tax.

Taxpayer's receipt of payments – designated and segregated as payments for property taxes – falls squarely within the statutory definition of "taxable income." Taxpayer's efforts to characterize the receipt of these payments as pass-through events having no taxable effect, is unavailing. The property tax expenses are merely one of those numerous costs of conducting a leasing business which the taxpayer ultimately expects its customers – either directly or indirectly – to bear.

FINDING

Taxpayer's protest is respectfully denied.

II. Denial of Tax Refund for Calendar Year Ending June 30, 1995.

Taxpayer argues that it should not have been denied a tax refund purportedly due for taxes paid during the tax year ending June 30, 1995. During the audit, taxpayer provided copies of the revenue agents reports (RAR) for certain federal audit periods but was advised that the time allowed for any refund had expired as to all tax years addressed within the RAR and that, accordingly, the amended returns adjustments were "out of statute."

Department regulation 45 IAC 3.1-1-94 sets out the procedural steps whereby a taxpayer is permitted to seek a refund upon a change in the taxpayer's federal return or federal liability. The regulation states that, "All taxpayers, except resident individuals, are required to file a notice with the Department within 120 days after a modification of a Federal income tax return or a modification of a Federal income tax liability explaining the modification." 45 IAC 3.1-1-94; *See also* IC 6-3-4-6.

There is apparently no dispute that taxpayer failed to file an amended return within the requisite 120 days. However, taxpayer sets out a general equitable argument stating that, because the Department has assessed taxes for two years *prior* to the tax year ending June 30, 1995, it is entitled to claim the refund.

45 IAC 3.1-1-94 provides the Department with no discretion in this matter. In the absence of any statutory or regulatory authority to do so, the Department must decline the opportunity to waive the 120-day filing requirement.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the 10-percent Negligence Penalty.

Taxpayer has requested that the 10-percent negligence penalty, imposed under the authority of IC 6-8.1-10-2.1(a), be abated for the all of the taxpayer's income tax liabilities assessed during the years encompassed within the audit report. Taxpayer maintains that any mistakes it made were made in good faith and in the exercise of reasonable care.

IC 6-8.1-10-2.1(d) states that if a person, subject to the negligence penalty, imposed under IC 6-8.1-10-2(a), can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the Department, was due to reasonable cause and not due to willful neglect, the Department shall waive the penalty. 45 IAC 15-11-2(b) defines "negligence" as the failure to use reasonable care, caution or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard, or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations. Id.

In order to waive the negligence penalty, the taxpayer must demonstrate that its failure to pay the full amount of tax was due to reasonable cause. 45 IAC 15-11-2(c). Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed" Id. In determining whether reasonable cause exists, the Department may consider the nature of the tax involved, previous judicial precedents, previous Department instructions, and previous audits. Id.

Taxpayer has provided no substantive, statutory, or factual basis upon which the Department can justifiably be expected to find a reasonable cause for taxpayer's failure to pay the assessed tax deficiencies. The taxpayer various assertions and explanations – even taken together – do not rise to the level of "reasonable cause" sufficient to permit the Department to waive the negligence penalty assessed against an otherwise substantial and sophisticated taxpayer.

FINDING

Taxpayer's protest is respectfully denied.